No. 10,085

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GLADYS M. SHORES and HAROLD M. F. BEHNEMAN,

Appellants,

vs.

HENDY REALIZATION CO. (a corporation) (formerly the Joshua Hendy Iron Works), A. J. MAYMAN, C. B. MOORES, E. PRICE, A. E. WEBBER and W. R. BASSICK, individually and as the Directors of Hendy Realization Co., ELMER M. HYLAND and MORRIS LEVIT,

Appellees.

APPELLANTS' REPLY BRIEF.

BYRNE, LAMSON & JORDAN,
PAUL S. JORDAN,
Russ Building, San Francisco,
Attorneys for Appellants.

PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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APPELLANTS' REPLY BRIEF.

The major contentions advanced by appellees in this appeal in support of their position that the judgment of the District Court should be affirmed may be summarized as follows: (1) That the District Court had jurisdiction over the subject matter of these consolidated proceedings; (2) that the individual appellees became proper parties to the Hendy reorganization proceeding upon the filing of their petitions of February 19th and March 11, 1941; (3) that the judgment

of the District Court was proper on the merits; and (4) that the District Court properly issued a permanent injunction restraining appellants from hereafter questioning through court action the propriety of the cash bonus payments made by the Hendy Co. to appellees Bassick, Hyland and Levit on December 4, 1940.

Appellants' contentions and arguments respecting the above matters have been set forth in their opening brief and will not be repeated here. The purpose of this brief will therefore be to analyze and reply to the arguments advanced by appellees in support of their contentions outlined above.

I.

REPLY TO APPELLEES' CONTENTION THAT THE DISTRICT COURT HAD JURISDICTION OVER THE SUBJECT MATTER OF THESE CONSOLIDATED PROCEEDINGS.

In support of this contention, appellees start with the premise "that there is complete factual identity between the subject matter (propriety of the distributions to the managing officers) of appellees' petitions in the district court and appellants' declaratory relief actions in the state court" (appellees' brief, p. 27). Appellants agree with this statement insofar as it deals with the propriety of the *stock distributions* to appellees Bassick, Hyland and Levit, but repudiate it insofar as it may refer to the *cash or bonus distributions*—this for reasons hereafter expressed in this brief.

1. **Jurisdiction of the District Court Over the Subject Matter of Appellees' Petitions of February 19th and March 11, 1941.**

Appellees' argument that the District Court, sitting as a court of bankruptcy in the original Hendy reorganization proceeding, had exclusive jurisdiction over the question of propriety of the *stock distribution* to appellees Bassick, Hyland and Levit (the subject matter of appellants' two State Court declaratory relief actions) seems to be based upon the following grounds:

(a) Because the District Court had jurisdiction in the original reorganization proceeding resulting in the Hendy Plan of Reorganization;

(b) That the Hendy Co. and its creditors are affected by these State Court actions;

(c) That the District Court had continuing, ancillary or supplemental jurisdiction to enforce its decrees in the original reorganization proceeding.

It will be remembered that, by reason of appellees' petitions of February 19th and March 11, 1941, further prosecution of appellants' State Court actions has been permanently enjoined. The propriety of this injunction, of course, depends upon the jurisdiction of the District Court over the subject matter of those actions. With this in mind, appellants reply to the three points enumerated above as follows:

(a) The jurisdiction of the District Court over the original Hendy reorganization proceeding is not under attack here. Its jurisdiction over a controversy *aris-*

ing out of the Hendy Plan of Reorganization long after the same was consummated and carried into effect, and long after the reorganization proceeding had been terminated and closed by a final decree, is definitely in question. Appellees' argument seems to be that because the District Court approved the Hendy Plan and supervised its execution, it continued to have exclusive jurisdiction over any controversy later arising out of the Plan with respect to rights established thereby, irrespective of the nature of the controversy or other jurisdictional considerations, and without regard to the fact that the reorganization proceeding had been terminated.

The absurdity of such an argument is, of course, obvious, and it is unsupported by any citation of authority in appellees' brief. If extended to its logical conclusion, such a rule of jurisdiction would lead to some very strange results. To illustrate, we suggest the following example:

> A debtor in reorganization proceedings gives new notes to creditors under a plan which provides for acceleration of maturity in the event that the debtor makes a net profit in a stated amount in any year during the five years following approval of the plan. "Net profit", as a term, is not defined in the plan. The plan is confirmed, the notes are delivered, and a final decree is entered in the reorganization proceedings, without reservation of jurisdiction. Three years later, a note holder claims that debtor's "net profit" for the prior year has been such as would entitle him to immediate payment of his note. This is denied by the debtor. The note holder then wants to sue

> on his note. May he bring his action in a State Court, or must he file a petition in the old reorganization proceedings? If the latter, how could the bankruptcy court render a judgment which would entitle the note holder to his money, if his contention regarding the meaning of the term "net profit" is correct?

An application of appellees' reasoning to the foregoing example would preclude the creditor from seeking to protect his rights in the State Court, and would require him to litigate his differences with the debtor only in the bankruptcy court. Appellees' reasoning would restrict the litigation of all controversies as to property rights stemming out of reorganization proceedings exclusively to the bankruptcy court, irrespective of how long subsequent to the formal closing of the proceeding the controversy might arise, and irrespective of the nature of the controversy. This is not the law. If it were, rights created by a Federal court judgment could never be made the subject of litigation in a state court (*United States, etc. v. Douglas,* 113 N. C. 190, 18 S. E. 202, 203).

We are not here presented with a case where appellants, by their State Court actions, seek to upset, question or nullify something previously determined by order of the District Court. The sole controversy presented by these consolidated cases deals with the propriety of the stock distribution by the Hendy Directors to appellees Bassick, Hyland and Levit under the circumstances developed by the evidence, as described in appellants' opening brief. This was con-

ceded by appellees' counsel at the commencement of the trial in the District Court (Tr. pp. 525, 526). A determination of this controversy depends upon whether, almost five years after the Hendy Plan was confirmed, the affairs of that company had been *successfully rehabilitated* within the meaning of the Hendy Plan. This is a question of fact to be determined in the light of circumstances occurring long subsequent to the closing of the Hendy reorganization proceeding on January 27, 1937. As we have previously pointed out, the Hendy Plan does not afford, and no order of the District Court prescribes, a definition of the term "successful rehabilitation". No circumstances under which such event would be deemed to have been accomplished are outlined in the Plan or in any order of the District Court. In other words, this is not a case where appellants are seeking to obstruct or interfere with any previously well defined order or direction of the District Court, and there accordingly exists no reason why the question in controversy cannot be determined in the State Court, where originally presented. Under the circumstances, the State Court had exclusive jurisdiction over this controversy.

(b) Appellees contend that the Hendy Co. and its creditors are interested in this controversy regarding the propriety of the stock distribution in question. They argue that appellants are "seeking to vitiate the plan of reorganization by squeezing some $100,000 out of the Hendy creditors" (appellees' brief, p. 34), and add there that the "purpose of reorganization proceedings is to promote a better realization of claims

of creditors than would occur through immediate liquidation".

Let us examine the facts. Under the Hendy Plan, as confirmed, the creditors agreed to a scaling down of their claims from $644,732.27 to $569,969.72 (Tr. p. 532). Their future rights under the Plan were thus established within well defined limits. Following the sale of the Hendy plant at Sunnyvale on November 15, 1940, the $274,966.57 (Tr. p. 628) of those deferred obligations then remaining unpaid were fully satisfied. At this point, the creditors ceased to have any further interest in the Hendy Co. or its Plan—they had been paid in full. Regardless of what happened to the Hendy stock in controversy, i.e., whether it was distributed to the managing officers or returned to the treasury of the company, the Hendy creditors could expect no more than they had received. Therefore, to say that they were "squeezed" of $100,000, or any other sum, is to distort or ignore the simple and uncontroverted facts. The Hendy creditors simply are not interested in, or in any way affected by, this controversy.

The Hendy Co. can in no way be adversely affected by appellants' State Court declaratory relief actions. The relief therein sought is exclusively against the individual appellees. The corporation was joined merely as a nominal party defendant, these actions being in the nature of stockholders' representative suits. The subject matter of the controversy presented by those actions is the Hendy stock in question—not property of the Hendy Co. The only dispute revolves

around the right of appellees Bassick, Hyland and Levit to retain that stock. This is a matter of concern to the appellee Hendy Directors, inasmuch as the propriety of their actions in distributing the stock is in question. It is also a matter of concern to appellees Bassick, Hyland and Levit, the distributees of the stock, for their right to future liquidating dividends to be declared on the stock is dependent upon their right to retain it. The old Hendy stockholders, for whose benefit the State Court actions were brought, are also vitally interested, for the disposition of future liquidating dividends is at stake. Regardless of the outcome of this litigation, the Hendy Co. will suffer no detriment, one way or the other. If appellants prevail, the stock in question will merely be retired to the treasury.

(c) Appellees argue that the District Court had ancillary jurisdiction "to enforce its decree in the reorganization proceeding" (appellees' brief, p. 37). In this connection, we assume appellees have reference to the decree of March 24, 1936, confirming the Hendy Plan and directing that it be carried into effect. To this statement they might well have added "as that decree is interpreted by appellees", for such would be consistent with their theory of jurisdiction in these consolidated proceedings. However, the answer to this argument is that the District Court in its final decree entered on January 27, 1937, found that the Hendy Plan had by that date been "fully executed, carried out, and accomplished" (see Paragraph 11 of the Final Decree, Tr. p. 229). In other words, reor-

ganization had been completed, there was nothing more to be done which required court supervision or direction, and the reorganization proceeding was accordingly, to quote the final decree, "terminated and closed; * * *" (Tr. p. 231).

To bolster their argument of continuing jurisdiction, appellees contend (1) that the court reversed jurisdiction in its order of March 24, 1936, confirming the Hendy Plan (appellees' brief, p. 45); (2) that the final decree of January 27, 1937, restrained stockholders from instituting suits of the character of appellants' State Court actions (appellees' brief, pp. 42, 43); and (3) that said final decree itself contains a reservation of jurisdiction (appellees' brief, pp. 45 to 47). Appellants reply to each of these three propositions, in their order, as follows:

(1) The reservation of jurisdiction in the March 24, 1936, order confirming the Hendy Plan was merely to empower the court to thereafter make any orders necessary to carry the Plan into effect. The Plan had been fully executed and accomplished by January 27, 1937, as stated in the final decree of that date, and the purpose of the reservation in the prior order confirming the Plan accordingly ended. In other words, the final decree superseded the order confirming the Plan and the reservation of jurisdiction contained in the latter order was accordingly terminated (see *In re Corona Radio & Television Corp.*, 102 Fed. (2d) 959 at 962).

(2) Examination of the restraining order contained in the final decree shows that creditors, claim-

ants and stockholders of the debtor corporation were enjoined from bringing suits against the debtor, the trustee, or properties of the debtor "based upon any right, claim, or interest which any such creditor, claimant, or stockholder *may have had in, to, or against the debtor*" (Tr. p. 231). This prohibition applied only to *past claims,* that is, claims which existed prior to entry of the final decree, and would not, therefore, affect actions of the nature of appellants' State Court actions, which present a controversy which did not arise until distribution of the stock in question on December 20, 1940. Furthermore, this controversy affects neither the Hendy Co. nor any of its property, as previously pointed out.

(3) Appellees' argument that the final decree contained a reservation of jurisdiction to deal with the controversy now before the court is indeed a novel one and is based upon a tortured interpretation of certain language contained in Paragraph 16 of the final decree (Tr. pp. 231, 232). Paragraph 16 reads as follows:

> "That the proceedings for the corporate reorganization of the debtor in this court entitled 'In the Matter of The Joshua Hendy Iron Works, a corporation, debtor, No. 25937-S', be, and the same hereby are, terminated and closed; such termination and closing to be for all purposes final upon the filing herein of receipts showing the payment of the final fees and expenses hereinabove allowed, *and the surrender and exchange of the stock certificates which have not yet been surrendered and exchanged as provided in said plan of reorganization.*" (Italics ours.)

Appellees contend that the italicized portion of the above quoted language constitutes "a clear reservation of jurisdiction for the purpose of effectuating the entire plan of reorganization" (appellees' brief, pp. 46, 47), and, accordingly, that jurisdiction over the controversy presented here was retained. Any such interpretation is unsound, for this language obviously refers to the surrender of shares by the old Hendy stockholders, contemplated by Paragraph 6G 2 of the Hendy Plan (Tr. pp. 186, 187), in exchange for which the stockholders received Trustees' Receipts and Certificates to the extent of 50% of the shares so surrendered (appellants' brief, pp. 6, 7). That *all stockholders,* including appellants, had surrendered their old shares and had received their Trustees' Receipts and Certificates in exchange long prior to December 20, 1940, the date of distribution of the stock here in question, and long prior to commencement of appellants' State Court actions, is conceded by appellees (appellees' brief, pp. 6, 7), and there is no intimation that the fees allowed in the final decree were not promptly paid. The purpose of this limited reservation of jurisdiction until the stock was *"surrendered and exchanged as provided in the plan"* was thus fully accomplished, and the reservation accordingly ceased to exist long before the question presented here ever arose. After entry of a final decree in a Section 77-B reorganization proceeding, the court is without jurisdiction except as to such matters as are specifically reserved therein (*In re Argyle-Lakeshore Bldg. Corp.,* 98 Fed. (2d) 372), and the limited reservation of jurisdiction under discussion here certainly

does not constitute a general reservation of jurisdiction for all purposes. We are here concerned with the propriety of the *stock distribution* to appellees Bassick, Hyland and Levit on December 20, 1940, and that transaction involves neither a *surrender* nor an *exchange* of stock.

Appellees place great store in the argument that the controversy presented here is subject to the continuing or supplemental jurisdiction of the District Court. In doing so, they ignore certain important factors which must necessarily have a bearing on the question of whether this is a case where this type of jurisdiction can be invoked, namely, (1) the lack of a general reservation of jurisdiction in the final decree in the reorganization proceeding; (2) that no property within the court's control is involved; (3) that appellants' State Court actions do not attack or seek to nullify or interfere with any matter or thing previously determined by the District Court in the reorganization proceeding; and (4) that the parties to, and the subject matter of, the State Court actions *are not the same as in the reorganization proceeding.*

The first three points listed above have already been discussed in this brief. As to the fourth point, it is well settled that a court of equity has ancillary jurisdiction only when the *subject matter and the parties* are the same in the original and in the ancillary action (*Root v. Woolworth,* 37 L. Ed. 1123). It is equally well settled that a supplemental bill, filed after the determination of the original cause, is not ancillary. The parties to a controversy in the

Federal Court cannot, under the guise of supplemental pleadings filed after the principal controversy has been determined, vest the Federal Court with jurisdiction over parties or subject matter as to which it had no original jurisdiction (*Omaha Horse Ry. Co. v. Cable Tramway Co.,* 33 Fed. 689; Appeal dismissed, 140 U. S. 674).

The individual appellees apparently do not contend that they were ever parties to the original reorganization proceeding, so only the question of similarity of the subject matter of the original reorganization proceeding and the subject matter of the State Court actions need be considered here. The subject matter of the original reorganization proceeding was, of course, the reorganization of the Hendy Co.—the formulation of a reorganization plan. The subject matter of the State Court actions relates to the propriety of the stock distribution to appellees Bassick, Hyland and Levit, a question that obviously was not, and could not have been, before the court in the original reorganization proceeding. As previously pointed out, this question must be determined in the light of the events and circumstances occurring long after the original reorganization proceeding was finally terminated and closed, events and circumstances which by their very nature could not have been anticipated by the court when the Plan was confirmed.

In urging that the doctrine of ancillary jurisdiction is applicable here, appellees entirely ignore the authorities cited on page 37 of appellant's opening

brief and rely principally upon *Local Loan Co. v. Hunt,* 292 U. S. 234 and *In re Hermitage Bldg. Corp.,* 100 Fed. (2d) 597. Each of these cases involved an interference with, or the disregarding of, previous Federal court orders, and are readily distinguishable from the case presented here.

The *Hunt* case arises out of an ordinary proceeding in bankruptcy. Following entry of an order discharging the bankrupt from all of his debts, a creditor sued him in a State Court to enforce a prior obligation, thus disregarding the discharge. The bankrupt thereupon petitioned the bankruptcy court to enjoin further prosecution of the State Court action. An injunction was properly granted, this being a clear case where the court was justified in invoking its ancillary jurisdiction to restrain the disregard of its discharge decree.

In the *Hermitage* case the debtor corporation had been reorganized under Section 77-B of the Bankruptcy Act. Under the plan, new stock was to be issued for the old stock during the ensuing five years upon the happening of certain contingencies. A final decree was entered, under which the old stockholders were specifically enjoined from instituting court actions for issuance of the new stock until those contingencies were met. In direct violation of this injunction, appellant, an old stockholder, filed a bill in the State Court against Directors of the debtor to enforce issuance of the new stock. The Directors then moved to strike this bill upon the ground that the State Court was without jurisdiction; that ap-

pellant's remedy was in the Federal court, and that the State Court action was barred by the injunctive order in the final decree. Acting upon the motion, the State Court *directed* appellant to present the matter to the Federal District Court. Without appealing this ruling, and acting upon this direction, appellant then voluntarily *intervened* in the original reorganization proceeding. Upon a hearing of this *intervention* petition, the District Court enjoined further prosecution of the State Court action. On the appeal from this injunctive order, the Circuit Court of Appeals held that the State Court action was contrary to the injunction in the final decree.

It is obvious that neither of these cases is controlling in the situation presented here. It is also pertinent to note that both the *Hunt* and *Hermitage* cases are from the Seventh Circuit, the same circuit which decided the cases relied upon by appellants as determinative of the question of the effect of a final decree containing no general reservation of jurisdiction (see appellants' opening brief, p. 37).

In Note 83 appearing on page 27 of appellees' brief, appellees contend, briefly and without elaboration, that the question of the District Court's right to permanently enjoin the State Court action brought by appellant Behneman under Section 403 of the California Civil Code (described in appellants' opening brief, pp. 33 to 35) is *not jurisdictional.* This contention is without merit, and appellees do not attempt to justify it. In their petition of March 11, 1941 (which supplements their petition of February 19,

1941), appellees refer to this State Court action, as well as to the Shores and Behneman declaratory relief actions, alleging that "if *said actions* are allowed to proceed irreparable injury and damage will be done" to appellees, and that "*said actions* constitute and are an unwarranted and improper attack and attempted infringement of the sole and exclusive jurisdiction of the above entitled court and its order dated March 24, 1936" (Tr. pp. 287, 288). Acting upon this petition, the District Court temporarily restrained further prosecution of this action under Section 403 of the California Civil Code, as well as the Shores and Behneman declaratory relief actions, in its order of March 11, 1941 (Tr. pp. 290, 291). Appellants' motion to dismiss appellees' said petitions and to vacate the temporary restraining order was made on jurisdictional grounds (Tr. p. 336), and was denied. The temporary restraining order was made permanent in the District Court's judgment of November 15, 1941 (Tr. p. 134). Appellants' specification of error No. II (appellants' opening brief, p. 18) is specifically directed at the District Court's denial of appellants' above described motion to dismiss. These facts clearly demonstrate that the question of the District Court's right to permanently enjoin further prosecution of the State Court action under Section 403 of the California Civil Code is wholly and entirely *jurisdictional*. In fact, insofar as this action is concerned, nothing other than jurisdiction to enjoin its further prosecution is involved, for the merits of this action were not in issue in the trial before the District Court.

2. **Jurisdiction of the District Court Over the Subject Matter of the Shores and Behneman State Court Actions.**

Appellees argue that inasmuch as the District Court has jurisdiction to entertain appellees' petitions of February 19th and March 11, 1941 in the reorganization proceeding, it had jurisdiction to render the judgment appealed from, regardless of whether or not the Shores action was properly removed from the State Court (appellees' brief, p. 53). This begs the question, for if, as contended by appellants, the District Court did not have jurisdiction over appellees' petitions, then the propriety of removal of the Shores action from the State to the District Court becomes highly material.

The Shores action was removed upon the sole ground that the complaint in that action presented a "Federal question" within the meaning of the removal statute (28 U. S. C. 71). As demonstrated in appellants' opening brief, a bill or complaint presents a Federal question only where the allegations thereof present a case in which the recovery depends upon the construction of a law of the United States. If the validity, construction or effect of such a law is not the subject of a bona fide dispute, then a Federal question is not present (see appellants' opening brief, pp. 45, 46).

Appellees contend that the Shores action "necessarily involves the construction of the Bankruptcy Act" (appellees' brief, p. 54). This contention is definitely unsound (appellants' opening brief, pp. 47 to 51). Appellees further urge that "the rights asserted by the parties in the Shores action are rights

arising under a law of the United States, namely, the Bankruptcy Act'' (appellees' brief, p. 55), but this argument fails for lack of any satisfactory explanation. The mere fact that the Shores action seeks to enforce property rights originating out of a reorganization plan approved under Section 77-B of the Bankruptcy Act does not make it one which arises under the Constitution or laws of the United States within the meaning of the removal statute, for no dispute or controversy respecting the validity, construction or effect of the Bankruptcy Act is presented by the Shores complaint (see cases cited appellants' opening brief, pp. 48-50; also *Metcalf v. Watertown,* 128 U. S. 586; *Pope v. Louisville Railway,* 173 U. S. 573). The fact that the Shores complaint may call upon the State Court to interpret language contained in Paragraph 6G 2 of the Hendy Plan does not present a Federal question, for the interpretation of this language does not rest exclusively with the District Court. There is no reason why a State Court cannot properly construe it (appellants' opening brief, pp. 49, 50).

There is still another reason why the propriety of the removal of the Shores action to the District Court is vitally important. The individual appellees are *all named as defendants* in the Shores action. However, although they were not parties to the original reorganization proceeding, they nevertheless saw fit to file their asserted ancillary petitions of February 19th and March 11, 1941 in that proceeding without previous application for leave to intervene. If, as appellants contend, this course was improper, and if,

as appellants likewise contend, the original Hendy reorganization proceeding was closed upon entry of the final decree on January 27, 1937, then the controversy presented here was never properly before the District Court unless the removal of the Shores action was proper.

II.

REPLY TO APPELLEES' CONTENTION THAT THEY BECAME PROPER PARTIES TO THE HENDY REORGANIZATION PROCEEDING UPON THE FILING OF THEIR PETITIONS OF FEBRUARY 19TH AND MARCH 11, 1941.

The individual appellees make no contention that they were parties to the original reorganization proceeding. They cheerfully admit that their petitions for injunctive relief of February 19th and March 11, 1941 were filed without previous application for, or order permitting, intervention. Appellants' objection to this oversight is lightly cast aside with the excuse that such an objection "obviously relates to a mere technicality and does not affect the substantial rights of the parties" (appellees' brief, p. 48). Appellees' argument seems to be that if they had taken trouble to petition for the right to intervene such petition would have been granted; that their right to intervene was absolute because their interest was based on property in the control of the court; and that their failure to follow the prescribed procedure regarding intervention did not affect the substantial rights of the parties.

The act of intervening, of course, contemplates the pendency of *existing litigation* (*Adler v. Seaman,* 266 Fed. 823), and appellants have elsewhere demonstrated that the original Hendy reorganization proceeding had ceased to exist upon entry of the final decree of January 27, 1937. If this is true, then appellees' petitions of February 19th and March 11, 1941 were original in character, were dependent upon jurisdictional grounds other than those involved in the original reorganization proceeding, and regular process should have been issued upon the filing thereof. But assuming, for the purpose of argument, that the original proceeding had not been closed when appellees filed their said petitions, they then could not escape the necessity of formal intervention in that proceeding. Rule 24 (c) of the Rules of Civil Procedure for the District Courts of the United States distinctly prescribes the procedure to be followed by a person desiring to intervene in any action. This section applies to bankruptcy proceedings (*In re Finger Lakes Land Co. Inc.,* 29 Fed. Sup. 50). It has been pointed out that in *all cases,* whether the right to intervene is conditional or unconditional, statutory or non-statutory, the person desiring to intervene must serve a motion to intervene upon all parties affected thereby. Like other motions, it must state the grounds therefor, and it must be accompanied by a pleading which sets forth the claim or defense for which intervention is sought (*Moore's Federal Procedure,* Vol. 2, p. 2367).

The prescribed procedure established by Rule 24 was admittedly not followed by appellees. Further-

more, their right to intervene, if any, was purely permissive, thus falling under subdivision (b) of the Rule, for none of the circumstances conferring an unconditional right under subdivision (a) of the Rule were present.

In arguing that appellants were not prejudiced by their failure to properly intervene, appellees rely on 28 U. S. C., Sec. 391. However, this section merely deals with the power of Federal courts to grant new trials in jury cases and can have no bearing upon the point here under discussion.

Although the point was raised before the Special Master, his report of March 28, 1941 contains no discussion or finding regarding the failure of the individual appellees to file a petition in intervention (Tr. pp. 293 to 335). One of appellants' grounds of objection in the District Court to this report was this failure to properly intervene (Tr. pp. 371, 372), but ruling on these objections was reserved by the court until after trial, and the Master's report was finally approved in the judgment appealed from, thus for the first time giving appellants a ruling on their objections (Tr. p. 133). Had the matter of appellees' right to intervene in the original reorganization proceeding been presented to the District Court in the proper way, the questions of jurisdiction involved here would have been raised at an early stage of this litigation and might have been finally determined by an appeal without the expense of a lengthy trial on the merits. Appellants have ac-

cordingly been very definitely prejudiced by the lack of a timely and proper application for intervention in the manner prescribed by Rule 24 (c).

III.

ANSWER TO APPELLEES' CONTENTION THAT THE JUDGMENT OF THE DISTRICT COURT WAS PROPER ON THE MERITS.

Appellants contend in their opening brief (p. 51), and here contend, that on the merits of this case the fundamental and only question before the court is whether or not the stock distribution to appellees Bassick, Hyland and Levit on December 20, 1940, was proper. This was conceded by appellees at the time of trial (Tr. pp. 525, 526, 552), but is denied by them on this appeal (appellees' brief, pp. 58, 59).

Distribution of the stock in question can be justified upon one ground only, namely, that the distribution was made in accordance with Paragraph 6G 2 of the Hendy Plan. This paragraph contemplates distribution to the managing officers only *"as a reward for management and the successful rehabilitation of the company's affairs"*, and for no other reason. But in their brief (p. 59) appellees likewise attempt to justify this stock distribution on the additional ground that it was also made "pursuant to repeated assurances to the managing officers in consideration of which these officers had been working for partial compensation". Paragraph 6G 2 of the Plan does not authorize the Hendy Directors to make any such assurances. If assurances of this charac-

ter were a reason for motivating the stock distribution, and this appears to be definitely the case (see resolution of Hendy Board adopted on December 20, 1940, set forth at pp. 16 to 19 of appellees' brief; also Paragraph VI of appellees' petition of February 19, 1941, Tr. pp. 237 to 239; and also Finding of Fact XII, Tr. pp. 109, 110), then the stock distribution was definitely improper.

Appellants' position with respect to the proper interpretation to be placed on the language of Paragraph 6G 2 of the Hendy Plan has been fully stated at pages 51 to 63 of their opening brief, and will not be supplemented here. However, with respect to appellees' argument that the affairs of the Hendy Co. had been *successfully rehabilitated* on December 20, 1940, we wish again to direct the court's attention to the fact that prior to that date all operating assets of the Hendy Co. had been sold; proceeds of this sale of capital assets had been resorted to in order to pay off balances still due the old deferred creditors; the going concern value of the company had thus been destroyed, and proceedings for the corporate dissolution of the company had been instituted. In other words, the Hendy Co. had been definitely and finally put out of business by December 20, 1940. This, we submit, was not the type of "successful rehabilitation" contemplated by Paragraph 6G 2 of the Hendy Plan.

IV.

APPELLANTS' REPLY TO APPELLEES' CONTENTION THAT THE DISTRICT COURT PROPERLY ISSUED A PERMANENT INJUNCTION RESTRAINING APPELLANTS FROM HEREAFTER QUESTIONING THE PROPRIETY OF THE CASH BONUS PAYMENTS MADE TO APPELLEES BASSICK, HYLAND AND LEVIT ON DECEMBER 4, 1940.

In the Shores complaint only the stock distribution to appellees Bassick, Hyland and Levit is questioned—the payment of cash bonuses to these appellees is not attacked, and no relief is prayed for with respect to such payments (Tr. pp. 3 to 23). It is true that in Paragraph III of the complaint in the Shores action it is alleged that *between March 24, 1936 and November 15, 1940* appellees Bassick, Hyland and Levit, as employees of the Hendy Co., were *adequately* compensated for their services. This allegation was denied in appellees' answer to the Shores complaint (Tr. pp. 51, 52). It is also true that in Paragraph VI of appellees' petition of February 19, 1942 (Tr. pp. 237 to 239), it is alleged that the compensation paid to appellees Bassick, Hyland and Levit was not *commensurate* with the value of their services, and that this allegation was denied by appellants in their answer to this petition. An issue was thus raised as to the *adequacy* or *inadequacy* of the compensation paid to these appellees up to November 15, 1940. However, inasmuch as the *adequacy* or *inadequacy* of their compensation could not, as already pointed out, have any bearing on the propriety of a stock distribution under Paragraph 6G 2, this issue was not material to the determination of these consolidated causes.

Under none of the pleadings filed herein was any issue ever raised as to the *propriety* or *impropriety* of payment of the cash distributions made to appellees Bassick, Hyland and Levit on December 4, 1940. Appellees do not so contend in their brief, but, on the contrary, refer to "the *inadequacy* of the compensation of the corporation's managing officers" pleaded in their petitions (appellees' brief, p. 77). Without question, all of the evidence referred to in appellees' brief (pp. 76, 77) dealt merely with the question of *adequacy* of the compensation paid to the management prior to sale of the Hendy plant on November 15, 1940—not with the *propriety* of payment of the cash bonuses paid on December 4, 1940. There was no evidence introduced by any party which will support the court's finding of fact that the cash distribution of December 4, 1940 was *proper* (Finding No. XVI, Tr. p. 118), or its conclusion of law that these cash distributions were "due, reasonable, and proper and should be ratified, approved and confirmed" (Conclusion No. III, Tr. pp. 128, 129).

Whether the cash compensation paid to appellees Bassick, Hyland and Levit prior to November 15, 1940 was *adequate* is one thing—whether the bonus payments of December 4, 1940 were *proper* is something else. No issue presenting the question of *propriety* of the cash bonus payments was either raised by the pleadings or during the trial. Accordingly, the injunction contained in the judgment appealed from, restraining appellants from attacking the *propriety* of the cash and bonus distributions to appel-

lees Bassick, Hyland and Levit, (Tr. p. 135), is highly improper and should be dissolved. As pointed out in appellants' opening brief (p. 65), there is presently pending a State Court action attacking the *propriety* of the cash and bonus payments of December 4, 1940. This action was commenced only a couple of months before the trial of these consolidated causes and involves an issue which under no circumstances can be said to arise out of the Hendy reorganization proceeding or the Hendy Plan of Reorganization. If the existing permanent injunction is permitted to stand, appellants and the other stockholders of the Hendy Co. will for all time be deprived of their right to a judicial hearing and determination on the *propriety* of the December 4, 1940 bonus distributions—an issue not presented here.

CONCLUSION.

For the reasons, and under the authorities, set forth in appellants' opening brief, and in their foregoing reply brief, it is submitted that the judgment of the District Court in these consolidated causes should be reversed.

Dated, San Francisco,
October 19, 1942.

Respectfully submitted,
BYRNE, LAMSON & JORDAN,
PAUL S. JORDAN,
Attorneys for Appellants.